No. 16,815

IN THE

United States Court of Appeals

For the Ninth Circuit

CATHERINE C. STARK,
Appellant,

vs.

ARTHUR S. FLEMMING, SECRETARY OF THE DEPARTMENT OF HEALTH, EDUCATION AND WELFARE OF THE UNITED STATES,
Appellee.

BRIEF FOR APPELLEE.

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Subject Index

Table of Authorities Cited

Statutes and Regulations

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JURISDICTION.

Jurisdiction is founded under Title 28 United States Code, Section 1291.

PROCEEDINGS BELOW.

Catherine C. Stark, appellant herein, filed application for old-age and survivors insurance benefits with the Bureau of Old-Age and Survivors Insurance of the Social Security Administration on July 2, 1957, alleging employment by Stark Properties, Incorporated, from February 15, 1956, to June 30, 1957 (Exh. p. 92). After due investigation the Bureau determined

that remuneration received from Stark Properties, Incorporated, was not wages under the Social Security Act, and the appellant was so notified by letter on November 20, 1957 (Exh. p. 107). Dissatisfied with the determination, the appellant on May 8, 1958, requested a hearing before a referee of the Social Security Administration (Exh. p. 109). Such a hearing was held on October 28, 1958, with the appellant present and represented by counsel (Tr. 31 et seq.). On November 25, 1958, the referee rendered his decision denying the appellant's claim (Tr. 18-24).

On December 23, 1958, the appellant requested a review of the referee's decision (Tr. 16), which request was denied on April 3, 1959 (Tr. 15). Under the regulations of the Social Security Administration, when the Appeals Council denied said request for review, the referee's decision became a "final decision" of the Secretary of Health, Education and Welfare within the meaning of, and subject to judicial review pursuant to the provisions of Section 205(g) of the Act (42 U.S.C.A. 405(g)).

On May 18, 1959 appellant filed an action under Title 42, U.S.C., Section 405(g) for review of the decision of the Secretary of Health, Education and Welfare. The Government filed the transcript in the above matter with its answer and subsequently moved for Summary Judgment. In an opinion handed down on November 23, 1959 United States District Judge William T. Sweigert granted the Government's Motion for Summary Judgment. *Stark v. Flemming,* 181 F. Supp. 539.

STATEMENT OF THE FACTS.

The appellant was born on May 30, 1888, and became age 65 on May 29, 1953 (Exh. Tr. 94). She had lived for many years with her husband on a farm in South Dakota which he owned. The farm was operated pursuant to a partnership arrangement between the appellant's husband and one Dexter Wobig, although her husband retained the sole ownership of the farm (Tr. 37, 48, 80, 95 et seq.). The appellant and her husband had spent several winters in California. While in California, the appellant's husband died on January 27, 1956. Since her husband's death the appellant has lived in California (Tr. 36, 48, 83).

Shortly after her husband's death, the appellant in consultation with her son, Franklin Stark, who lived in California decided to form a corporation. This corporation, known as Stark Properties, Incorporated, was formed as a California corporation on February 9, 1956 (Tr. 39; Exh. p. 99). All the assets of the corporation were contributed by the appellant. These assets consisted of a 160 acre farm in South Dakota which was left to her by her husband, the equity in a duplex house in Oakland, California, which she had owned since 1951, and $4,199.10 in cash which was left by her husband (Tr. 46 et seq., 81-82, 92). On December 29, 1956, the appellant also contributed $1,560 to the corporation (Tr. 44-45, 64-65, 97).

In consideration of the transfer of the equity in the duplex property which was about $2,000 and the initial cash contribution of $4,199.10 the appellant was issued 65 shares of stock with a par value of $100 a

share (Exh. pp. 117, 118). No further stock was issued to any other person and no more stock was issued to the appellant upon her later contribution of $1,560 (Tr. 97). In addition to the stock, $20,000 worth of debenture bonds were issued to the appellant in return for her conveyance to the corporation of the farm in South Dakota which was estimated to be worth $20,000 and which was held free of any encumbrances (Exh. pp. 117, 118).

The Board of Directors was composed of the appellant, her son and the son's wife. The appellant was president and treasurer of the corporation and it was agreed that she would receive $400 a month as remuneration for her activities in connection with the corporation (Tr. 43). Her son was the secretary of the corporation and her daughter-in-law, Alice Stark, acted as vice-president (Tr. 66). Neither the son nor the daughter-in-law received any remuneration for their activities in connection with the corporation (Exh. p. 103). The corporation's place of business was listed as the hotel room where the appellant lived (Tr. 46).

The appellant, in a written statement in evidence, alleged that she performed extensive tasks in connection with her position as president of the corporation. The appellant declared that she entered into leases for the corporation of the farm, took care of taxes, insurance and repairs with regard to the farm and unsuccessfully tried to sell that property. She also maintained that she managed the duplex property in Oakland and stated that she handled all the general book-

keeping and fiscal matters of the corporation. She concluded her written description of her duties by saying that "My job was a full time job and I averaged in excess of 40 hours a week on it." (Exh. p. 103.)

At the hearing under the guidance of her attorney the appellant repeated her earlier assertions as to her duties (Tr. 53 et seq.). However, when questioned by the referee the appellant experienced great difficulty in explaining her tasks and why they took up so much of her time (Tr. 94). She testified that the lessee, Dexter Wobig, was honest and experienced and that she wrote about one letter a week to him or to her sister-in-law and brother-in-law who lived across the road from the South Dakota farm (Tr. 95). She also stated that her efforts to sell the farm were principally confined to Mr. Wobig (Tr. 91). With regard to the duplex, the appellant stated that her tenants were prompt in paying their rent and that they mailed their payments to her. She either mailed in the mortgage payments on the duplex or went to the bank herself (Tr. 91). Repairs for the duplex were handled by telephone calls and the appellant testified that she had employed a hired man who took care of these repairs. This man was not employed by her at the time of the hearing but he had been employed by her for several months after the corporation was formed (Tr. 93-94). Although the appellant had alleged she kept the corporation's books she admitted that the entries in the books were made by a public accountant (Tr. 46). When asked by the referee how these duties could have required over 40 hours a week, the appellant re-

plied that when she wasn't actually performing services, she was thinking about the job (Tr. 94).

The appellant returned to the farm in South Dakota for about 3 or 4 weeks in the summer of 1956 (Tr. 51). While there, she sold some tools and equipment for $258.90 (Tr. 56, 89).

The appellant's son handled the legal matters of the corporation and prepared the corporation's income tax return. He also prepared the corporation's Book of Minutes (Tr. 44). As previously noted, the appellant was to receive $400 a month. She made out the checks to herself and the son signed them (Tr. 44); $4,200 was reported for the appellant as wages for 1956 and $2,400 was reported for the first six months of 1957 (Exh. p. 96). The corporation's financial statements showed a net loss of $3,221.78 for 1956 and a net loss of $671.12 for 1957. The parties admitted that they were well able to estimate the income and expenses of the corporation from the operation of the properties and thus, could have foreseen the losses which the corporation sustained (Tr. 77).

The appellant retired on July 1, 1957, from her positions as president and treasurer because of alleged ill-health (Exh. p. 99). She introduced into evidence her physician's records showing office visits from February through April 1957, and the record of a week spent in a hospital from February 27, to March 7, 1957 (Exh. pp. 114-115). Since her retirement the son has acted as president and treasurer, but has received no compensation (Tr. 100).

After discussing the evidence substantially as above, the referee proceeded with his findings, reasonings and conclusions as follows (Tr. 23-24):

> "It is perfectly apparent, and the referee finds, that the real purpose of forming this corporation was to qualify claimant for Social Security coverage. The income that she would otherwise have received from these properties was rent income, and as such is specifically excluded from coverage under the Social Security Act, Section 211(a)(1). The corporation clearly had no bona fide business purpose. The operation of these properties could just as well and much more cheaply have been carried on without the interposition of a corporation. Claimant's purported salary was startlingly excessive in the terms of good business management. The corporation was not organized for profit, on the contrary, it was formed with the expectation of running at a loss.
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> * * * * * * *
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> "The basic purpose of congress in enacting the Social Security Act was to provide for the replacement of earnings lost by virtue of retirement. Only those persons were intended to be benefited who, on the basis of earnings for services rendered, had contributed to the maintenance of the Social Security fund. Contributions are in the form of taxes paid by the individual and his employer measured by the amount paid for services, which, it was assumed would be the fair value of the services rendered. Benefits are computed in proportion to the taxes so paid. Income from capital invested, including rents from real property, are definitely excluded from coverage. Nor was it

ever intended that a person could, simply by paying taxes from his private funds, become entitled to Social Security benefits—earnings from services rendered being the basis of benefits.

"It is clear and the referee finds that this corporation was designated to defeat this congressional purpose by (1) converting into purported employment income, income from rents, that Congress intended should be excluded from coverage, and by (2) using claimant's own funds as purported employment income for the purpose of making Social Security returns. The corporate entity, therefore, is in this case disregarded by the referee and he finds that claimant in her purported capacity of president and treasurer of said corporation was acting solely for herself, and that the amounts paid on her account as Social Security taxes were actually paid by herself from her own funds without basis in services rendered by her in any capacity, and so cannot serve to qualify her for Social Security benefits.

"It follows from the foregoing findings, and the referee finds and concludes, that claimant does not have six or more quarters of coverage as required by the Social Security Act, and was therefore not fully insured. It is his decision that she is not entitled to Old-Age Insurance Benefits as applied for by her."

Even apart from the effect of the substantial evidence rule (discussed infra), we submit that the findings of the referee including the controlling findings that the appellant "does not have six or more quarters of coverage as required by the Social Security

Act and was therefore not fully insured," are plainly correct.

QUESTION PRESENTED.

Was the District Judge correct in granting Summary Judgment for the defendant-appellee?

ARGUMENT.

From the facts as found by the referee in accordance with the evidence, there would appear to be no basis for any conclusion other than the one he reached. The appellant was actively connected with Stark Properties, Incorporated, for just 18 months or 6 quarters, the *minimum* period necessary to obtain an insured status under the Act. Furthermore, she withdrew $4,200 as remuneration for the first year, which was the *maximum* amount creditable as wages under the Act. In addition to the coincidence of time and amount, the evidence plainly shows that the corporate structure had never been used by the appellant or her husband prior to the years in issue and no plausible reason was advanced as to why it had suddenly been utilized contrary to previous practice.

The appellant alleged that she gave up her position as president on July 1, 1957, because she became ill. This explanation appears questionable because the evidence shows that the appellant was under a doctor's care earlier in that year while she was still president. She had improved by the summer when she chose to

retire. Moreover, when the appellant retired in July 1957, purported wages had been reported for her for the minimum period required for coverage under the Act. The amount of remuneration which appellant received further illustrates the contrived nature of the instant situation. The appellant received $4,200 in 1956 and $2,400 for the first six months of 1957, which amounts would obtain for her the maximum benefits under the Act. The duties which she performed did not warrant such compensation.

Most important, however, the evidence reveals that the appellant's activities were minimal. She only made one business trip to the farm in South Dakota after her husband's death. The lessee of the farm was experienced and there was little the appellant had to do. The same was true of the duplex apartments. The appellant admitted that her tenants were good and that the few dealings she had to transact could mostly be taken care of by mail and telephone. In the light of these facts, the appellant's assertion that she spent *in excess of 40 hours a week* performing her tasks appears dubious (Exh. 5, Tr. 103). When asked by the referee at the hearing how her simple duties could have required so much time the appellant said "My mind was working when my hands were not working" (Tr. 81).

The illusory character of the compensation which the appellant received is further made manifest upon the realization that the corporation did not earn enough in either 1956 or 1957 to pay the appellant from current earnings. The appellant's remuneration

was paid from capital funds. In the light of the fact that the appellant herself contributed the capital of the corporation it becomes clear that she was merely contributing funds to the corporation with one hand and taking them out with the other in the attempt to establish an earnings record to entitle her to benefits under the program.

When the appellant retired, her son took her place as president and treasurer. He received no compensation for his activities in connection with the corporation nor has the corporation compensated anyone else since the appellant gave up her offices. No explanation was advanced why the appellant was paid maximum creditable amounts, whereas it has not been necessary to compensate anyone else for services performed for the corporation since her retirement.

A case which bears a close resemblance to the instant matter is *Gancher v. Hobby,* 145 F. Supp. 461 (U.S. D.C. D. Conn. 1955). In that case the claimant, a physician, organized a corporation together with his wife and daughter and conveyed to the corporation a building which had been paid for by the claimant and was held in his wife's name. The building was composed of three residential apartments, two of which were occupied by the claimant and members of his family, and the claimant's office. The claimant and members of his family purported to pay the corporation rent and, in turn, the claimant purported to draw wages from the corporation for alleged services rendered to the corporation. The referee in the *Gancher* case denied the appellant's claim for benefits and denounced

schemes that are contrived merely to gain social security benefits in the following manner:

> "* * * There is nothing improper or questionable about a person entering bona fide employment for the express purpose of acquiring a wage record which will enable him to qualify for an old-age insurance benefit. Such action is clearly within the spirit, as well as the letter, of the law. However, it is a far different thing to create a relationship and give to certain payments the color of 'wages' for the purpose of qualifying under a law such as the one here in question. That is neither within the letter nor the spirit of the law. *Even though the Fredja Corporation might have certain legal respectability as far as State law is concerned, its organization apparently for the sole purpose of having claimant as one of its officers, and presumably as an employee, so as to qualify for social security benefits appears to have been nothing but a sham.* * * *" (Emphasis supplied.)

The court in the *Gancher* case affirmed the referee's conclusions and issued a Memorandum Decision in which it set out the essential fact-finding portions of the referee's decision, including that portion which we have quoted above, and held as follows:

> "A study of the testimony shows that the Referee's conclusions which were adopted and became the basis for the Department's decision, were amply supported by substantial evidence. The foundation of the corporation, the 'employment' of the appellant and his application for social security benefits were all features of what was intended to have been a *slick scheme concocted in the mind of the appellant's son, Louis Gancher, and engi-*

> *neered by him improperly to acquire contributions for his father's support from the Social Security administration.* * * *" (Emphasis supplied.)

It is significant that in the instant case, as in the *Gancher* case the attempt was made to qualify an individual needing only 6 "quarters of coverage" for benefits by means of purported payments of wages, through the device of a corporation. That the alleged "salary" was the amount needed to gain the maximum benefit, under the Act is very significant, as is the fact that the alleged salary was alleged to give plaintiff the exact minimum of 6 "quarters of coverage." To allow the interposition of a corporation, formed solely as a scheme to enable the plaintiff to obtain a lifetime annuity under the Social Security Act, as the present one obviously was, is to nullify the purpose for which the old-age and survivors benefit program was established.

The cases cited by the appellant to support its position serve only to reinforce that of the government.

As the majority opinion in *Flemming v. Lindgren,* 275 F.2d 596 (9th Cir., 1960), stated (at p. 597) "where . . . [claimant] was using this rather shallow corporate device, the government was entitled to take not one but several long looks at it." The majority also pointed out that many factors should be considered and that the "decision still leaves the administrator of the Act broad latitude for the exercise of his discretion."

The concurrence was even more specific. Judge Pope distinguished this very case on the ground that, "The finding was that there was 'not in fact a bona fide employment for salary or wages,' " (at 598 footnote one). Furthermore, Judge Pope stated, "If it were found that the size and character and potentialities of that business were such that [the claimant] must have known that the business could never pay a salary sufficient to qualify him and if in consequence it were found and concluded that the employment was only a simulated one then the situation would be otherwise." (p. 599.) It should be noted that this is exactly the situation we have here.

In *Rafal v. Flemming,* 171 F. Supp. 490 (E.D.Va., 1959), plaintiff sold his packing business to his two sons for a consideration of $17,000 evidenced by a promissory note and retired from business. Two years later Rafal entered into a partnership agreement with his sons, under which it was agreed that he would be entitled to the sum of $3,600.00 per year from the profits of said partnership, which sums would be credited against the payment of the aforesaid negotiable promissory note. It was further agreed that the three partners would (1) share equally in the losses and (2) give undivided time and their attention to the business. It was conceded that Rafal worked 48 hours per week during all of 1954 and 1955, the years in question. The referee found that these earnings did not constitute net earnings from self-employment and that therefore Rafal was without sufficient quarters of coverage to be considered a fully insured individual under the provisions of the Social Security Act.

In effect, the referee ruled that plaintiff had made a gift of his services during the two years in controversy. The court in reversing the referee ruled that rather than a gift of his services Rafal had made a gift to his sons of the financial remuneration received for such services. The court pointed out that if the partnership had been without profits in the years in question the plaintiff would not have been entitled to any money and the note would not have been credited with any payments. Indeed, in such a situation, the sons would have been obligated to pay Rafal the $50 per week specified by the promissory note. The court discussed the case of *Gancher v. Hobby,* 145 F. Supp. 461 and distinguished it from the *Rafal* case as being in sharp contrast. The court noted that there had been no "bona fide" services rendered to the corporation in the *Gancher* case and stated that it was clear that "*Gancher* is correctly decided", 171 F. Supp. 490, 495.

It is evident from the above recital of facts that the *Rafal* case is easily distinguishable from the captioned case by the fact that Rafal worked 48 hours a week devoting his full time to the partnership and by the fact that Rafal's salary was paid from the profits of the partnership. In the instant case the corporation which paid appellant showed a net loss for the 18 months in question and there can be no finding of bona fide service rendered to the corporation in the same manner or of the same type rendered by Rafal.

In *MacPherson v. Ewing,* 107 F. Supp. 666 (N.D. Cal., 1952) the employer and employee were strangers

who were dealing with each other at arm's length. In the instant action, however, the payments in question were made between a corporation controlled by the claimant and the claimant herself. *MacPherson* cannot possibly be made to stand for the proposition that, where the claimant is an employee of a corporation that she controls, transactions between the two parties may not be carefully scrutinized in order to determine whether there existed more than mere bookkeeping entries motivated by the coverage requirements of the Social Security Act.

Thorbus v. Hobby, 124 F. Supp. 868 (S.D.Calif., 1954), affirmed *sub nom. Folsom v. Poteet,* 235 F. 2d 937 (C.A. 9, 1956) is also unlike the instant action. In that case the Court of Appeals found that "Thorbus rendered many, many services to the tenants not associated with merely acting as lessor of an apartment to a tenant. * * * Thorbus did give, in our judgment, sufficient service of the hotel variety at his office, in the halls and at the doors of his tenants to bring him within the department's regulations for coverage under the statute." 225 F. 2d 937, 938. The many services which Thorbus rendered in what was essentially a hotel operation are set out in the District Court's opinion, 124 F. Supp. 868, 870 to 871. None of the services which plaintiff rendered on behalf of her corporation could be said to in any way match the services rendered by Thorbus.

The creation and existence of a corporation has also been disregarded in other cases involving claims for social security benefits. See the case of *Howatt v. Folsom,* 160 F. Supp. 490 (E.D.Pa. 1957), affirmed

253 F.2d 680 (3 Cir. 1958), wherein the plaintiffs unsuccessfully attempted to use the corporate device to circumvent the exclusion of family employment from covered employment under the Act (section 210(a)(3) of the Act, 42 U.S.C.A. 410(a)(3)). See also *Greenberg v. Folsom,* Civil Action No. 135333, U.S.D.C. E.D. N.Y., rendered on March 20, 1959 (unreported) which incorporated the court's earlier decision in that case, C.C.H., U.I.R., Vol. 1, Fed. para. 506.65. In that case, the administrative decision denying benefits to the plaintiff was upheld where the plaintiff had formed a corporation and then purported to pay herself a salary to write a book and sell real estate.

It is well settled that a corporate entity may not be used as a device for circumventing legislative policy. For example, in *Anderson v. Abbott,* 321 U.S. 349, 64 S.Ct. 531 (1944), the Supreme Court said (pp. 362-363):

> "* * * It has often been held that the interposition of a corporation will not be allowed to defeat a legislative policy, whether that was the aim or only the result of the arrangement. * * * The Court stated in Chicago, M. & St. P. Ry. Co. v. Minneapolis Civic & Commerce Ass'n, supra, 247 U.S. page 501, 38 S.Ct. page 557, 62 L.Ed. 1229, that 'the courts will not permit tremselves to be blinded or deceived by mere forms of law' but will deal 'with the substance of the transaction involved as if the corporate agency did not exist and as the justice of the case may require.' * * *"

See also *Moline Properties, Inc. v. Com'r. of Int. Rev.,* 319 U.S. 436, 63 S. Ct. 1132 (1943).

When the activities involved in the instant matter are scrutinized, they are revealed to be without substance and must be disregarded, if the Social Security Act and the legislative intent underlying it are to have any meaning. As the referee pointed out, the Social Security Act was designed to replace lost earnings of individuals who have retired from their labors. Indeed, from its inception, the Federal program for old-age and survivors benefits was planned for the purpose of underwriting some of the economic hazards of old age by providing a partial replacement for the earnings lost by individuals upon their retirement. Thus, in the Report of the Committee on Economic Security in 1935, the recommendation was made (at page 4):

> "To meet the problem of security for the aged we suggest as complementary measures non contributory old-age pensions, compulsory contributory annuities, and voluntary contributory annuities, *all to be applicable on retirement at age 65 or over.*" (Emphasis supplied.)

The concept that rights to benefits are accumulated on the basis of activities which demonstrate a capacity for earnings has been reiterated continually by the legislative bodies which have been concerned with the establishment and the development of the program. See, for example, the report of the Committee on Ways and Means (Report No. 615, 74th Congress, 1st Session, 1935, at page 19):

> "This title provides for the payment of cash benefits to every individual who has attained the age of 65 and has fulfilled certain qualifications.

> These benefits will be paid to him monthly as long as he lives in an amount *proportionate to the total amount of wages received by him for employment* before he attained the age of 65." (Emphasis supplied.)

(See also report of the Senate Committee on Finance (Report No. 628, 74th Congress, 1st Session, 1935, at page 31).)

This same philosophy of the Act is reflected in Senate Report No. 1669 (81st Congress, 2nd Session) wherein the Senate Finance Committee recommended a broad extension of the coverage provisions to include under the system the self-employed as well as previously excluded groups of employees. The report states:

> "We believe that improvement of the American social-security system should be in the direction of preventing dependency before it occurs, and of providing more effective income protection, free from the humiliation of a test of need."

Accordingly, the committee recommended action designed to immediately bolster and extend the system of old-age and survivors insurance by extension of coverage, increasing benefit amounts, liberalizing eligibility requirements, and otherwise improving this basic system for dealing with income losses.

It is thus apparent that the purpose of the Act in all respects is to provide a partial replacement of the moneys earned by one actively pursuing employment or self-employment, when that active pursuit is terminated by age. The appellant in this case has not

lost any earnings due to retirement because she has never had any bona fide wages or creditable self-employment income. She has at all times received only rental income which is specifically excludable by section 211(a)(1) (42 U.S.C.A. 411(a)(1)) of the Act from net earnings from self-employment creditable for social security purposes. She has merely attempted to convert her excludable rental income into creditable wages by manipulating her funds from one account to another. Moreover, the appellant has not really even given up her property because she remains the sole stockholder in the corporation which now has title to the farm and the duplex property.

If the appellant's scheme is allowed to succeed it will defeat not only the Congressional intent underlying the coverage provisions of the Act, but also the deductions from benefit provisions of the statute. Section 203(b) of the Act (42 U.S.C.A. 403(b)) provides that, when an individual's claim has been determined and he has been awarded benefits, deductions may nonetheless be made from such benefits if he thereafter realizes certain minimum "earnings." "Earnings" for this purpose is defined in section 203(e)(4)(A) and (B) (42 U.S.C.A. 403(e)(4)(A) and (B) as "the sum of his wages for services rendered" plus "his net earnings from self-employment." These deductions provisions further carry out the basic philosophy of the Act which is to replace lost earnings. The appellant who has retired from her "salaried" positions, still remains the sole stockholder of the corporation and, as such, she could in the future purport to receive her rental income as dividends from the corporation

and thus escape deductions from any benefits which might be awarded to her. In reality nothing will have changed. The appellant at all times has, and will have, received rental income from her farm and duplex property. Her artifices clearly contravene the purposes of the Social Security Act in every conceivable way.

In the instant case the referee was faced with a situation which has arisen many times since the Social Security Act was amended in 1950, effective January 1, 1951, so as to provide for a so-called "new start" which enabled many elderly persons to gain insured status with only 6 "quarters of coverage." Thus, many persons saw an opportunity to realize a substantial return on a small investment, by paying a small amount of purported social security taxes for a few months with the hope of thereby obtaining old-age insurance benefits for the remaining years of their lives. Various schemes of contrived coverage have been resorted to, and when the facts of these contrived cases are analyzed in accordance with the various criteria for determining a valid employer-employee relationship, it clearly appears, as here, that the purported employment relationship falls far short of the legal requirements for such a relationship.

The appellant in this case who was recently widowed and was over age 65 when the arrangement in question was entered into, has attempted to augment her income by the payment of a nominal amount of social security taxes for a short period of time. An analysis of the facts shows that the corporation was formed for no

other purpose than to serve as a conduit for the appellant's funds and that no bona fide employment relationship was ever intended or entered into.

The Social Security Administration does not have the burden of proving that a person claiming benefits is not entitled thereto. Congress has prescribed, as to each category of benefits under the Act, the conditions which must be met for entitlement to such benefits. Although the Administration does not consider itself to be, and does not act as, an adversary of a claimant for benefits, it cannot allow a claim where the evidence does not affirmatively establish that the prescribed conditions of entitlement have been met. Moreover, even apart from the provisions of the Act, it is well settled that the burden of proof rests upon the one who files a claim with an administrative agency to establish that the required conditions of eligibility have been met. *Norment v. Hobby,* 124 F. Supp. 489 (N.D.Ala. 1953); *Thurston v. Hobby,* 133 F. Supp. 205 (W.D.Mo. 1955); both involving claims for social security benefits. See also *Eschbach v. Contractors, Pacific Naval Air Bases,* 181 F.2d 860 (7 Cir. 1950); *Ashford v. Appeal Board,* 238 Mich. 428, 43 N.W.2d 918 (1950); *Department of Industrial Relations of the State of Alabama v. Tomlinson,* 251 Ala. 144, 36 So.2d 496 (1948) (in which the Alabama supreme court held, citing a number of decisions by courts of other States also holding, that a claimant under a State unemployment compensation law has the burden of proof to establish his right to benefits, and that *"The claimant assumes the risk of nonpersuasion"* (emphasis supplied)).

The decision rendered by the referee is supported by the terms of that part of section 205(g) of the Social Security Act (42 U.S.C.A. 405(g)), which reads: "The findings of the Secretary as to any fact, if supported by substantial evidence, shall be conclusive." This is fully recognized by numerous cases which arose and were decided under title II of the Social Security Act, including the following: *United States and Social Security Board v. LaLone,* 152 F.2d 43 (9 Cir. 1945); *Rosewall v. Folsom,* 239 F. 2d 724 (7 Cir. 1957); *Teder v. Hobby,* 230 F.2d 385 (7 Cir. 1956); *Walker v. Altmeyer,* 137 F. 2d 531 (2 Cir. 1943); *Social Security Board v. Warren,* 192 F.2d 974 (8 Cir. 1944); *Ferenz v. Folsom,* 237 F.2d 46 (3 Cir. 1956), certiorari denied 352 U.S. 1006; *Hobby v. Hodges,* 215 F. 2d 754 (10 Cir. 1954); *Folsom v. O'Neal,* 250 F.2d 946 (10 Cir. 1957).

These cases also show that the finality accorded by the Act to the administrative findings extends not only to the evidentiary or basic facts, but also to ultimate findings drawn therefrom as inference or conclusion. As stated by the United States Court of Appeals for the Ninth Circuit in *United States and Social Security Board v. LaLone,* supra:

> "Under this section of the Social Security Act providing for appeals from an administrative board, as under the other similar acts, the board's findings of fact must be sustained if the court finds they are supported by substantial evidence. This same finality extends to the board's inferences and conclusions from the evidence if a substantial basis is found for them. * * *"

Even if there were no disputes as to the evidentiary facts, the court could not substitute its own inferences or conclusions for those of the referee. *Livingstone v. Folsom,* 234 F. 2d 75 (3 Cir. 1956); *Walker v. Altmeyer,* supra; *Social Security Board v. Warren,* supra. In *Thurston v. Hobby,* supra, the court said inter alia:

> "A rule of adjective law is that *uncontroverted evidence is not necessarily conclusive of the existence of fact if analysis of surrounding circumstances leaves the mind in a state of conjecture;* under such circumstances its weight and credibility are left to the trier of the facts. * * * [Citing cases.]
>
> *Uncontradicted testimony need not be accepted by a trier of facts as true, where there is something in the evidence or in the tale, itself, which furnishes a basis for discrediting it because of its inherent improbabilities.* Therefore, in the instant review proceeding, it would appear that if the inference and conclusions reached by the Appeals Council are permissible ones on the record made, we have no duty other than to affirm it, even though we might have reached a different conclusion if it had been submitted to us in an original proceeding."

The case of *Larmay v. Hobby,* 132 F. Supp. 738 (D.C.E.D. Wisc. 1955) is particularly in point as delineating the meaning of the term "substantial evidence," and the Court therein also discussed the duty and prerogative of the Secretary to determine the credibility of the witnesses and the sufficiency of the evidence. In that case, the court said:

"* * * Certainly if this matter were before a jury on testimony and return of the defendant, a court could not direct a verdict. It would at least present an issue of fact. The test of substantiality involves such relevant evidence as a reasonable mind would accept as adequate to support a conclusion, * * * [Citing cases.] 'Substantial' evidence means enough evidence to justify, if the trial were to a jury, a refusal to direct a verdict when the conclusion sought to be drawn from it is one of fact for the jury. [Citing cases.]

* * * * * * *

"In any event, *the credibility of the testimony of a witness is to be judged upon the basis of those inconsistencies as well as the means of the witness' information and interest in the suit.* United States v. Ybanez, C.C., 53 F.536. Also the case of Lee Sing Far v. U. S., 9 Cir., 94 F. 834, pronounces the rule that *it is for the Referee to determine the credibility of the witness and the sufficiency of the evidence.* The Judgment to credibility is made among other criteria *upon the basis of the probability of the story* with reference to the witness' opportunity to observe the facts testified *and his interest in the proceeding."* (Emphasis supplied.)

For a discussion of the scope of judicial review that is within the power of the district court in an action under section 205(g) of the Social Security Act see the district court's decision in the recent case of *Carqueville v. Folsom,* 170 F. Supp. 777 (N.D. Ill. 1958) wherein the court affirmed the referee's decision denying the plaintiff's claim for benefits. See also the opinion of the Court of Appeals for the Seventh Cir-

cuit, 263 F. 2d 855, rendered on January 15, 1959, wherein the decision of the district court was upheld.

In conclusion, the appellee submits, that even apart from the substantial evidence rule, it is clear that on the basis of the evidence in this case, the referee was amply warranted in finding, and that he correctly found that no employment relationship existed between the appellant and the corporation.

Therefore the judgment of the district court should be affirmed.

Dated, San Francisco, California,
July 26, 1960.

Respectfully submitted,

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